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SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

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INVESTMENT BANKING: THE ONLY GAME IN TOWN

SPECIAL EMPIRICAL REPORT: 1988 PERFORMANCE OF DOMESTIC BROKER-DEALERS

Highlights

1. The securities industry, measured only by domestic broker-dealer operations, posted $2.5 billion in pre-tax profits last year, double 1987's crash-impacted level but half 1986's profits. The 1988 gain was concentrated in investment banking firms while retail firms struggled to remain profitable.

2. The largest retail houses, the National Full Line firms, posted losses in their broker-dealer units for the second straight year. Their 1988 revenues were down 7%; revenues from commissions and mutual fund sales fell 33% and 31%, respectively.

3. Regionals' 1988 revenues shrank 15% and profits plummet 61% to their second lowest level of the Eighties. Commissions fell 27% while mutual fund revenues dropped 52%!

4. Discounters' 1988 profits fell 70% on 33% less commission revenue and 19% less overall revenue.

5. Large Investment Banks also had a 36% drop in commissions. However, the M&A and repo business boomed, increasing almost $3 billion in 1988. Thus, total revenues increased 15% and profits doubled.

6. New York City-based firms, despite the commission pinch, had a 1988 $1 billion M&A and repo-related revenue increase for a 24% gain in total revenues while profits quadrupled.

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OVERVIEW

The bears were still running on Wall Street's retail track! The financial performance of domestic broker-dealers in 1988, the first full year after the October 1987 crash, was critically dependent upon whether they were retail-oriented.

The largest retail firms, the National Full Line (NFL) firms, posted losses in their broker-dealer units for the second straight year as a group. Their 1988 revenues were down 7% and the retail bellwether business lines, commissions and revenues from mutual fund sales, fell 33% and 31%, respectively, from 1987's level.

Regional firms' broker-dealer units, predominantly retail-oriented, saw 1988 revenues shrink by 15% and profits plummet 61% to their second lowest level of the Eighties. Commissions fell 27% while mutual fund revenues dropped 52%!

Discounters also felt the pinch with the absence of the individual investor. Profits were slashed over 70% on 33% less commission revenues and 19% less overall revenues.

These same business areas were also off at the institutional, investment banking houses. The Large Investment Bank (LIB) broker-dealers had a 36% drop in commission revenues while mutual fund revenues were halved. However, their investment banking advisory and repo reverse repo businesses boomed with an increase of about $3 billion in 1988 revenues. These gains offset depressed business lines and yielded a 15% increase in total revenues and a doubling of profits from 1987's level.

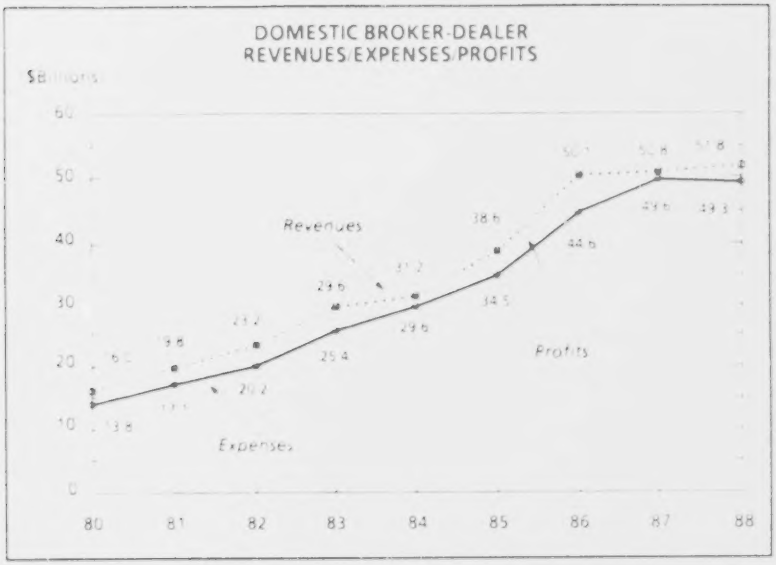
For the New York City-based "regionals" (NYCs), commissions also suffered cuts of 31% last year while mutual fund revenues fell 29%. But M&A and repo-related revenues increased $1 billion for a 24% gain in total revenues, while profits quadrupled to $418 million for these institutionally-oriented firms.

The following Trends analysis relies upon the NYSE member firms' domestic broker-dealer quarterly Financial and Operational Combined Uniform Single (FOCUS) Reports to the Exchange.

PROFITABILITY

The post-crash period has undoubtedly been one of the roughest times for broker-dealers, particularly for those in the retail business. But it comes on the heels of a decade of fantastic growth. For instance, from 1980 through 1986, revenues more than tripled from $16 billion to $50 billion, before remaining flat over the next two years. Likewise, expenses tripled through 1986 but didn't remain flat thereafter, squeezing profitability over the past two years (Exhibit 1).

EXHIBIT 1

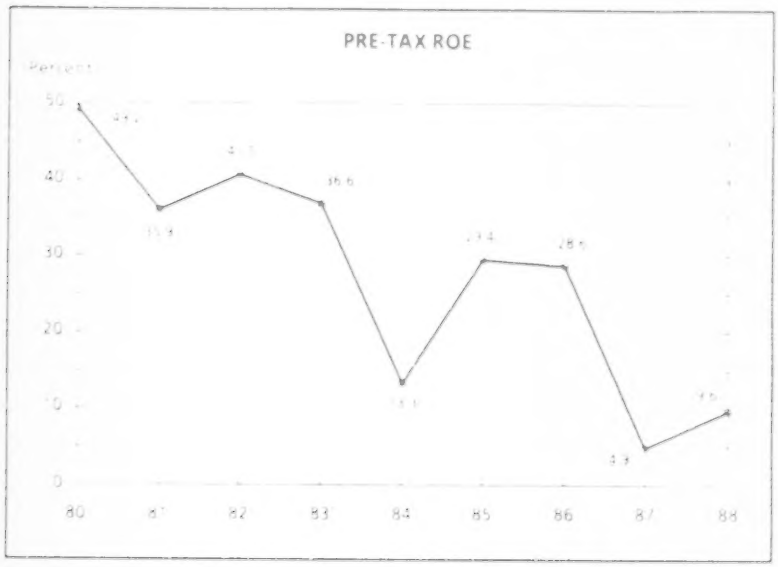


Prior to 1986, however, profit pressures were already underway as evidenced by the downward trend of pre-tax profit margins (Exhibit 2).

EXHIBIT 2

Likewise, return on equity has also been tracking steadily downward. Large equity infusions during the Eighties, from firms going public or seeking foreign and domestic partners, built up the capital base to support expanded businesses, particularly principal business lines. However, these volatile areas can generate sizable losses as well as gains. Spreads also narrowed in many business lines as firms, scrambling for revenues, all actively chased a finite amount of business. As Exhibit 3 shows, broker-dealers' pre-tax ROE fell from 50% in 1980 to under 10% last year, and as shown later, was even lower for retail firms.

EXHIBIT 3



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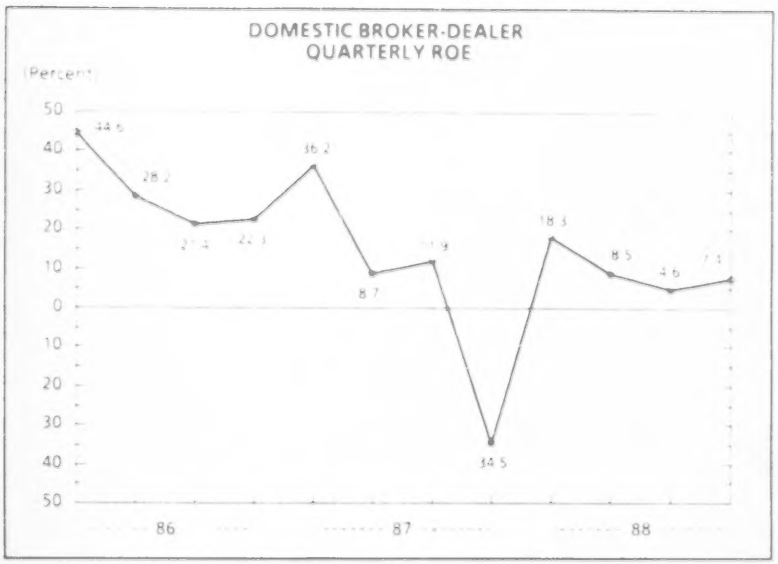
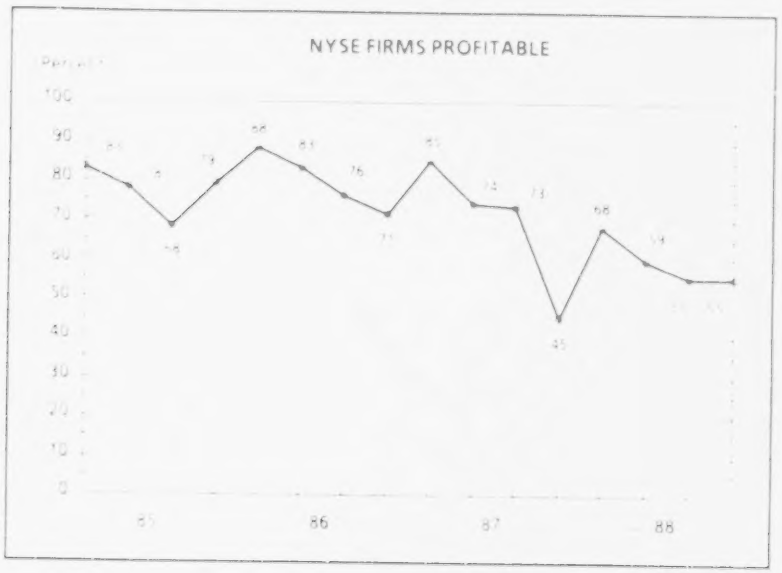


Looking at broker-dealer ROE quarterly since 1986 shows an unpleasant picture (Exhibit 4). ROE in 86:Q2 was only half the level of first quarter results. By mid-1987, it was halved again to around 10% and has been hovering below that level for the past three quarters.

As recently as 1986, about 70% to 90% of the NYSE member firms were profitable each quarter (Exhibit 5). During crash impacted 87:Q4, less than half the firms were profitable and in recent quarters, only 55% of the firms were in the black.

EXHIBIT 5



REVENUES

In 1988, domestic broker-dealer revenues increased $1 billion to $51.8 billion, or 2% (Exhibit 6). But this 2% gain is net of some very steep increases and decreases in individual business lines. Trading gains and investments for the firms' own accounts each increased $1.3 billion in 1988. The biggest gains, however, came from the M&A boom and net interest revenue which are reflected in the "other securities related" FOCUS revenue line. This line shot up $3 billion or 26%. Of that total, more than 90%, or $2.8 billion, came from the LIBs alone. If not for the Shearson Hutton merger, however, LIBs would probably account for a lesser, but still substantial, 70% of the growth in these businesses.

COMMISSIONS

Commission revenues, on the other hand, fell nearly $4 billion in 1988 or over 30%. Similarly, the value of trading on the NYSE (the source of 75% of all commission revenue) fell 27% last year. In 1987, the average daily value of equities traded on the Big Board was $7.4 billion. This fell to to $5.4 billion per day in 1988. In other words, last year, about $2 billion less in stock per day were traded on the NYSE.

EXHIBIT 6

STATEMENT OF INCOME
DOMESTIC BROKER-DEALERS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	12,646.4	8,784.1	(30.5)
Trading Profits	9,972.5	11,293.2	13.2
Investment Gains	67.8	1,391.9	NM
Underwriting	5,156.8	5,158.0	0.0
Margin Interest	3,352.3	3,028.6	(9.7)
Mutual Fund Sales	2,208.8	1,414.4	(36.0)
Fees, Account Supervision	1,811.5	1,888.6	4.3
Research	24.4	23.1	(5.3)
Commodities	1,093.4	1,378.7	26.1
Other Securities Related	11,680.4	14,702.6	25.9
Other Unrelated	2,798.5	2,761.6	(1.3)
Total Revenues	50,811.0	51,824.7	2.0
Expenses			
RR Compensation	9,335.1	7,582.0	(18.8)
Clerical Compensation	9,079.6	9,282.9	2.2
Partner Officer Comp.	1,508.1	1,337.7	(11.3)
Other Employee Comp.	630.7	527.8	(16.3)
Floor (Commission Clearing)	2,188.3	1,754.3	(19.8)
Communications	2,555.7	2,549.5	(0.2)
Occupancy & Equipment	2,729.3	3,052.9	11.9
Promotional Costs	1,203.1	1,003.2	(16.6)
Interest Expense	14,271.3	16,310.8	14.3
Errors Bad Debts	1,142.9	438.1	(61.7)
EDP	759.5	737.1	(2.9)
Non-Recurring Charges	99.5	56.1	(43.6)
Regulatory Fees	328.0	371.6	13.3
Other	3,806.3	4,330.8	13.8
Total Expenses	49,638.9	49,335.0	(0.6)
Pre-Tax Net Income	1,172.1	2,489.7	112.4

EXHIBIT 7

STATEMENT OF INCOME
DOMESTIC BROKER-DEALERS

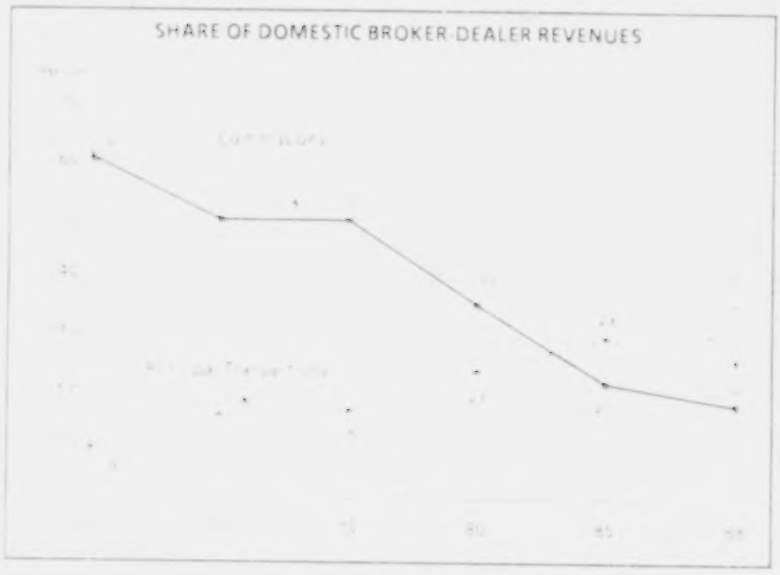
(In Percent)

Revenues	1987	1988
Commissions	24.9	16.9
Trading Profits	19.6	21.8
Investment Gains	0.1	2.7
Underwriting	10.1	10.0
Margin Interest	6.6	5.8
Mutual Fund Sales	4.3	2.7
Fees, Account Supervision	3.6	3.6
Commodities	2.2	2.7
Other Securities Related	23.0	28.4
Other Unrelated	5.5	5.3
Total Revenues	100.0	100.0
Expenses		
RR Compensation	18.4	14.6
Clerical Compensation	17.9	17.9
Partner Officer Comp.	3.0	2.6
Other Employee Comp.	1.2	1.0
Floor (Commission Clearing)	4.3	3.4
Communications	5.0	4.9
Occupancy & Equipment	5.4	5.9
Promotional Costs	2.4	1.9
Interest Expense	28.1	31.5
Errors Bad Debts	2.2	0.8
EDP	1.5	1.4
Non-Recurring Charges	0.2	0.1
Regulatory Fees	0.6	.0.7
Other	7.5	8.4
Total Expenses	97.7	95.2
Pre-Tax Net Income	2.3	4.8

There has been some pick-up in equity activity in 1988, but it's becoming harder for firms to earn a profit in this area. The 1989 increased activity and market levels are helping investors make a profit. But due to pricing pressures, securities firms aren't making much, if any, profit on this activity.

The drop in commissions was felt equally by investment banking and retail firms. LIBs, NFLs, NYCs, Regionals and Discounters all had about 30% drops in their commission revenues (Appendix A). Until last year, commissions generally rose year-to-year, doubling from $5.7 billion for all NYSE firms in 1980 to a record $12.6 billion in 1987, before 1988's 30% drop. As painful as this drop was, the previous growth in aggregate commissions masked the long-term downward trend in commissions' relative importance to total revenues.

EXHIBIT 8



As Exhibit 8 depicts, commissions accounted for over 60% of broker-dealer revenues a decade prior to May Day. By last year, commissions accounted for just under 17% of total revenues. Principal transactions (trading and investment gains) rose from under 10% of revenues in the Sixties to 30% by 1985. Last year, this percentage fell to 25% of all revenues despite a $2.7 billion increase in 1988 trading and investment gains, mainly because of exceptional growth in other capital market areas, particularly M&A fees and interest income. If the other capital market revenues such as underwriting and "other related" are added to principal transactions, the 1988 total comes to $32.5 billion, or nearly two-thirds of NYSE broker-dealer revenues (Exhibit 7).

MUTUAL FUNDS

The phenomenal growth of the retail "success" of the Eighties, mutual funds, came not only to a screeching halt with the crash, but in just two years, these revenues have been slashed in half (Exhibit 9).

EXHIBIT 9

The NFLs account for almost all of the NYSE broker-dealer mutual fund revenues -- $1.1 billion of last year's $1.4 billion total -- and thus mirror the overall decline. But the Regional firms, with lesser aggregates but more commission-dependent, were harder hit. They produced only $259 million from this source last year, down 52% from 1987 and less than two-fifths of the record $660 million they generated in 1986.

Mutual funds, which accounted for 13.3% of Regionals' 1986 revenues, also fell to two-fifths of their 1986 levels last year and accounted for just 6.2% of Regionals' revenues in 1988.

Another retail service which grew side by side with mutual funds (and also attracted a large amount of funds away from traditional deposit accounts), was the money market fund, together with automatic cash sweeps (into these funds) often tied to retail brokerage accounts today. These products were an unqualified success in bringing in business (asset gathering) and generating revenues but the flip side was a shrinkage of the percent of customer funds on which firms do not pay interest.

Since these balances are largely used to finance margin lending, brokerages have had to seek alternate, more costly sources of funds to finance this business. Unlike any other revenue source, margin interest revenues remained basically flat throughout the Eighties, and less a contributor to the growing revenue base. In 1980, 1982 and 1983, these revenues totaled $2 billion each year. For 1981 and during 1984-88, it totaled $3 billion annually. Total revenues, meanwhile, tripled from $16 billion in 1980 to $52 billion last year.

MARGIN INTEREST

Though margin interest has been flat, margin debt has not. Margin debt balances, averaging around $10 billion outstanding in 1980, steadily rose until just prior to October 1987. During that time span, these borrowings quadrupled, peaking at $44 billion in September 1987 (but averaging $38 billion for the year). Since then, the debt outstanding has averaged about $33 billion. According to Sanford C. Bernstein estimates, currently 60% to 70% of credit balances are interest bearing. With the disappearance of truly "free" credits, firms must now use alternative financing sources, such as the repo market, with a resultant higher interest expense.

In addition, interest rates over the same time frame basically headed downward (until last year), reducing the rate brokerages earned on margin debt outstanding. Also, the returns on margin lending are down. From 1980 to 1982, margin interest revenues averaged about 20% of margin debt outstanding, but only 10% for the past six years.

Over half of the NYSE broker-dealers' margin interest revenues are booked at the NFLs. NFLs' margin interest revenues have fallen from 20% of total revenues in 1981 to just 8% last year. Margin interest contributed a similar 19% to Regionals' total revenues in 1981 -- last year it accounted for only 7%. For the NYCs, margin interest fell from 19% to 3% of total revenues over the same seven years.

TRADING GAINS

Trading gains, principally from bonds, made a comeback last year, rising 13% to $11.3 billion, or 22% of total revenues (Exhibit 7). That's still below 1986's record highs and the 25% trading contributed to total revenues from 1982 to 1986. In 1987, major bond trading losses led to a 20% drop in these revenues: falling from 1986's $12.6 billion to 1987's $10.0 billion.

Throughout the Eighties, bond trading ranged from 65% to 75% of all trading gains. Last year, bonds' percentage of total trading gains bounced back up to 73% from 87's 68%, indicating investor activity shifting back to fixed income from equities.

Nearly half the NYSE broker-dealers' trading gains are booked by the NFLs. Last year, the NFLs' trading profits rose 16% to $5.1 billion from 1987's $4.4 billion, and very close to their 1986 record $5.5 billion.

Most of the balance of trading results are logged at the LIBs and the NYCs. The LIBs' $3.9 billion of 1988 trading gains held even with 1987's and 1985's results and was second only to their 1986 record $5.2 billion. For the LIBs, throughout the Eighties, a higher 75% to 80% of their gains were attributable to

bond trading. Last year, this percentage rose to a record 85%, underlying the heavy focus on fixed income by institutional investors last year.

The NYCs posted a 70% increase in trading profits last year to a record $1.1 billion. Although a record in dollar amount, trading still accounted for 18% to 19% of NYCs' revenues in both 1986 and 1988. Meanwhile, Regionals' 1988 trading gain of $880 million was up a slight 7% from 1987's results.

INVESTMENT GAINS

Investments for firms' own accounts reached a record $1.4 billion last year. In 1985 and 1986, the record levels being set were $1.1 billion annually before 1987's disastrous drop to nearly zero (due to a $1.3 billion investment loss in 87:Q4). The bounce-back in investment gains, moreover, was universal, extending to all categories of firms.

The NFLs went from a 1987 loss of $82 million in investments to a 1988 gain of $186 million. LIBs' 1987 gain of $95 million was tripled to $288 million last year. The NYCs went from investment losses of $77 million in 1987 to gains of $354 million last year while Regionals showed a 35% increase in these gains in 1988 to $51 million.

UNDERWRITING

Domestic underwriting revenues have been holding their own at $5.2 billion for the past two years although high yield and M&A related bond financings were last year's profit source vs. the equity underwriting bonanzas of 1985 and 1986. Their absence led to a 1987 and 1988 underwriting revenues sitting at 12% below 1986's record $5.9 billion, but these were still the two second best years.

Underwriting, particularly corporate underwriting, is a very concentrated business line in the securities industry. Almost all products underwritten are dominated by a handful of firms although about 300 firms participate to some measurable extent in the corporate and municipal primary markets.

The bulk of underwriting activity and revenues are attributable to two main firm categories: NFLs and LIBs. The LIBs' underwriting revenues have been holding steady the past three years at just under $2 billion annually. The LIBs, meanwhile, have captured a larger share of total underwriting revenues over the Eighties, climbing from 25% of industry underwriting revenues in the early 1980s to about 35% the past few years. This increase wasn't at the expense of the NFLs, however, which have maintained their 50% share of industry underwriting revenues throughout the Eighties.

Having a combined 85% of the market, it's not surprising that the steady level of $2 billion in underwriting fees for the LIBs and about $2.5 billion for the NFLs tracks well with the volume of total corporate underwritings (Exhibit 10). Municipal underwriting volume has trailed off since the Tax Reform Act of 1986 (Exhibit 11) and industry leaders in this field have been curtailing and abandoning this field (including NFL and LIB firms). Fortunately, these lost fees have been mostly offset by the growth of higher-fee corporate underwritings over the past few years.

EXHIBIT 10

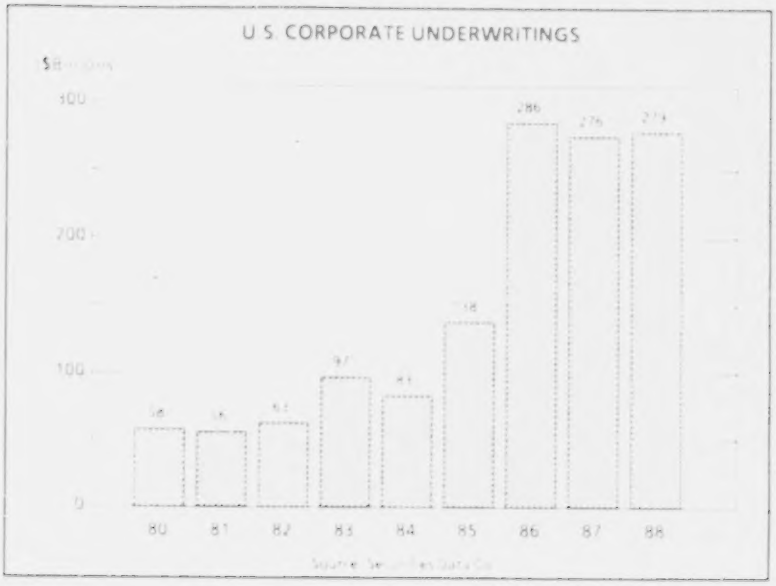
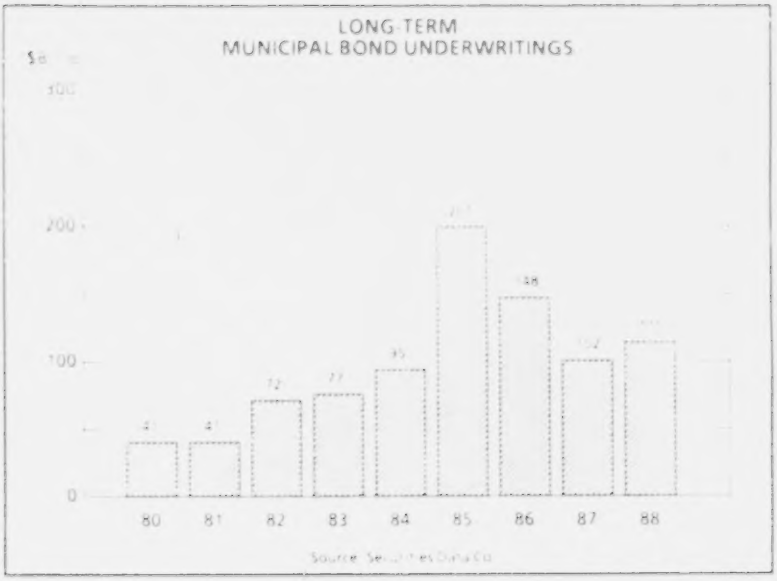


EXHIBIT 11



Regional firms, originally stung by the advent of SEC Rule 415 and the subsequent growth of non-syndicated deals, have fallen on further hard times in their underwriting business. Their 1988 underwriting revenues of $541 million were down 14% from 1987 and were the lowest level in four years. The absence of equity issues and municipal bonds, where Regionals have an underwriting presence, hurt this performance. Regionals also did not benefit from the fixed income underwriting growth of asset-backed and high yield bonds which are dominated by a few large firms.

By 1986, the NYCs reached a record $185 million in underwriting revenues, but two years later this revenue source was cut by more than half to just $80 million. Again, though total corporate underwriting volume remained steady over these years, the recent totals were fueled by asset-backed and high-yield bonds which are not the main underwriting products for this group.

OTHER SECURITIES RELATED REVENUES

The biggest revenue gains for NYSE broker-dealers came from the "other securities related" FOCUS revenue line which shot up $3 billion, or 26%, last year. Of that total, more than 90%, or $2.8 billion, came from the LIBs alone. This line is a catch-all for several business areas but the bulk of the revenues consist of M&A related fees, private placement fees and interest income from the repo businesses. Precisely how much each area contributes to the total is not broken out but in 1988 we estimate that the majority of the growth came from the M&A and repo areas.

M&A

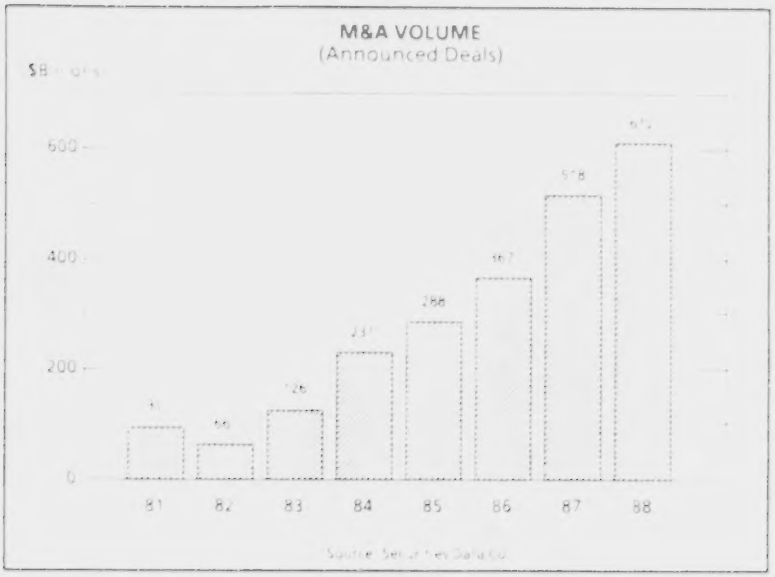
The LIBs, as well as the NFLs, command the bulk of the M&A-related business in the U.S. as well as most of the megadeals. But, due to the Shearson Hutton merger, NFLs' "securities related" revenues dropped by $600 million in 1988; otherwise, we estimate that this line would have increased by about $4 billion, or 34%, leaving the LIBs with about a 70% share. The NYCs also experienced a $900 million, or 65%, increase in this area.

Regionals' "other related" revenues broke through the half-billion dollar mark for the second straight year to a record $546 million. Combined with their principal transaction performance, it shows the Regionals are also following the industry trend of placing more capital in use for their own deals which seems to be the only profit game in town -- albeit a higher stakes game.

For all NYSE broker-dealers, "other related revenues" have increased 8.5-fold since 1980, climbing from $1.7 billion to $14.7 billion last year. Since a major amount of this revenue comes from M&A fees, it's not surprising that Exhibit 12's depiction of the growth in M&A volume closely parallels this revenue line. However, first quarter 1989 preliminary indications show some softening in the M&A boom but by no means an end to it.

Also, this revenue line has nearly tripled in importance to securities firms' total revenues during the Eighties. In 1980, "other related" revenues accounted for 10.8% of all NYSE broker-dealers' revenues -- last year this reached a record 28.4%, the single largest revenue source (if this "catch-all" line can be considered a single source).

EXHIBIT 12



This growth has been felt by all categories of securities firms but is nowhere more important than for the LIBs (although the NYCs are beginning to mirror the LIBs' growth in this area). Last year, LIBs' "other related" revenues reached a record $7.5 billion, up 59% from 1987's previous $4.7 billion record! Further, this line now accounts for a full 44.1% of the LIBs' total revenue, a drastic increase from 18% in 1980.

The LIBs also account for half of the revenue from these sources (M&A, private placements and repo activity), and thus drive the overall growth patterns in this area. The NFLs historically trailed the LIBs only slightly in this area (with 36% of the total), but last year they fell to just 25% of all revenues from these sources (again, mainly due to the loss of Hutton). The NYCs had fantastic growth of "other related" revenue, mainly from repo business and M&A merchant banking work. Here, 1988 revenues shot up 65% to a record $2.2 billion, or a whopping 40% of the NYCs' total revenue base.

REPOS

Besides M&A, the large increase in "other securities related" revenues has come from the growth of firms' repo and reverse repo transactions and inventory last year. For the NYSE firms, both repo and reverse repos outstanding were up about $50 billion from 1987 levels, or 25%. According to the Federal Reserve, all government securities dealers increased their repo activity 26% last year or by $70 billion and their reverse repo activity by $100 billion or over one-third. The securities firms with primary dealer status are concentrated in the NFLs, LIBs and NYCs. Also, as rates were rising in 1988, firms' interest earnings on their corporate and government repo book should have increased even without an increase in their positions.

For the LIBs, their repo and reverse repo inventories were also up 25% or by about $30 billion on average last year, which, when combined with their heavy M&A fees in 1988, led to their 59%, or $2.8 billion increase in "other related" revenues.

The closing of Hutton's repo book in 87:Q4 was by far the bulk of the $18 billion drop in NFLs' repo and reverse repo inventory which also was the main cause of the NFLs' 14%, or $600 million, drop in "other securities related" revenue. The drop in NFLs' interest income is actually larger than $600 million since NFLs had significant increases in M&A fees last year (which are combined with interest in this FOCUS line).

Heavy emphasis on the repo business by the NYCs led to a $1 billion increase in their "other related" revenues, one-third of the NYSE firms' increase. The NYCs' inventory of repos and reverse repos doubled in 1988 to nearly $50 billion each.

EXPENSES

Broker-dealers increased their repo book on both sides of the balance sheet last year (by $50 billion each or 25%) with a counterbalance to the boom in interest revenue -- increased interest expense. Total interest expense last year increased by $2 billion or 14%, also fueled by higher interest rates.

This trend had a major impact on the LIBs since their single largest and fastest increasing expense line is interest. The LIBs had a $30 billion, or 25%, increase in their repo and reverse repo inventories last year and a corresponding $2 billion, or 29%, increase in their interest cost. At $8.7 billion, interest expense ate up just over half of the LIBs' revenues and accounted for a full 55% of total expenses.

The NYCs had the biggest increase of all firm categories in their repo and reverse repo inventory -- it doubled. They also had the largest percentage increase in interest expense last year. Interest costs shot up 65% to a record $2.5 billion. For the NYCs, interest now accounts for just about half of all expenses, close to the LIBs' interest ratio.

The closing of Hutton's repo book slashed the NFLs' repo and reverse repo inventory and led to an $800 million, or 18%, decline in interest expense (which otherwise would have risen during 1988's rising rate environment). In 1988, all of the publicly held NFL firms had higher interest revenues and expenses in their consolidated financial reports. This drop in interest cost was also half of the total drop in NFL expenses in 1988, inflating their overall cost cutting picture.

COMPENSATION

The single largest expense for broker-dealers (second largest for LIBs and NYCs) is compensation costs. A main component of this cost is broker compensation which fell $1.8 billion last year. From a profitability standpoint, that's a movement in the right direction. Though RR compensation fell $1.8 billion, or 19%, commission revenues fell more than twice as far, down $3.9 billion or 31%. Additionally, nearly 9,000 registered representatives, or 9% of all RRs, have left the NYSE broker-dealers since the October crash. But, since nearly 5,000 of these brokers departed during 1988 (1,000 during the second half), some of the cost savings will not be reflected fully until early 1989.

Still, at a level of only 14.6% of revenues last year, RR comp is consuming by far the smallest portion of total revenues since data was first available in the 70s and probably the lowest level ever! During the previous 12 years, RR comp averaged 18% of total revenue and never averaged less than 16.8%.

More troubling is the continuous rise in clerical and administrative employee compensation expense to record levels. Despite a 9% cutback in the non-producer workforce since the crash (or nearly 15,000 positions), this expense item increased over 2% again last year to $9.3 billion. For the second straight year, clerical comp is still consuming a record 17.9% of total revenues despite announced plans to reduce these costs.

One reason may be that with many of the high-paid "non-RR" talent being reported here (i.e. M&A, corporate finance non-RR pros), their growth combined with the cutbacks in operations and clerical staff would leave a higher concentration of higher paid people in this expense line. Since that information is not available, total compensation may be a better measure.

Combining all direct payroll lines, total payroll expense fell $1.8 billion last year, or 9%. That matches the 9% reduction in the NYSE broker-dealers' workforce since the crash. At $18.7 billion, this is the lowest payroll since 1985. Additionally, payroll accounted for just 36.1% of total revenues in 1988, the lowest percentage this decade and down dramatically from the previous year's 40.5%. Viewed in this perspective, the industry appears to be addressing some of its compensation problems. Further reductions should be seen in 1989 from previous cuts and with further reductions already underway in 89:Q2.

EXHIBIT 13

EMPLOYEES

(In Thousands, End of Period)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	81.0	92.9	100.3	112.6	122.5	127.5	143.4	146.4	135.2
Lg. Investment Banks	15.8	17.8	19.9	23.9	25.1	27.0	33.5	38.1	33.5
Regionals	N.A	31.2	31.5	34.3	36.2	35.6	39.2	42.2	37.7
New York City Based	N.A	10.9	10.9	11.2	11.7	12.4	13.3	16.0	16.3
NYSE Discounters	N.A	0.6	1.2	1.6	2.1	2.7	3.8	5.0	4.3
All NYSE Firms	**139.8**	**160.6**	**171.0**	**192.0**	**207.5**	**214.6**	**244.1**	**260.5**	**238.6**

OTHER EXPENSES

One expense that has not been curtailed during these tough times is occupancy and equipment costs which rose 12% in 1988, breaking through the $3 billion barrier. O&E costs ate into a record 6% of total revenues last year. This "fixed" cost has been on the rise for quite some time, rising six-fold since 1980 and now eating up nearly twice the percentage of total revenue than in 1980. These "fixed" costs are not easily cut overnight.

Some firms have locked themselves into higher occupancy costs from pre-crash headquarter moves and expansion plans, while others took one time charges from cancelling such planned moves or building programs. Still, these cost increases were across the board for all firm categories.

However, published reports indicate that firms are now taking advantage of expiring leases and consolidating some branch offices. Therefore, 1989 may show some curtailment of this cost.

Fortunately, cost cutting measures did result in reduced expenses for almost every other expense item: communications, data processing, promotional and advertising, and floor brokerage expenses all fell in 1988. There are also indications that management is targeting further reductions in these costs for 1989.

SUMMARY

The retail business has been dormant since October 1987. Those firms concentrating in the capital markets, particularly M&A, merchant banking, principal trading, high yield financings, etc., have fared much better. Rising interest rates, however, have hurt these firms since their profits are very interest sensitive.

LIBs doubled their profit margin to 8.4%, the best of all firm categories (Exhibit 14). But at this level, it is still only second to 1987 for their worst profit margin in a decade. Similarly, the LIBs' return on equity doubled last year also to 18%, again the best, but still second only to 1987 for the LIBs' smallest return in a decade (Exhibit 15).

EXHIBIT 14

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	(0.3)
Lg. Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	2.6
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.2	7.4
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.1
All NYSE Firms	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.3**	**4.8**

EXHIBIT 15

PRE-TAX RETURN ON EQUITY

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	45.0	24.6	29.8	28.1	(2.6)	17.9	20.3	(2.1)	(0.7)
Lg.Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5	34.2	9.3	18.2
Regionals	N.A	37.2	36.0	40.5	6.8	29.0	32.7	14.1	5.4
New York City Based	N.A	42.1	43.3	50.7	19.9	31.2	38.3	3.9	15.0
NYSE Discounters	N.A	52.2	53.9	46.7	0.8	25.6	49.5	19.7	5.0
All NYSE Firms	**49.2**	**35.9**	**40.5**	**36.6**	**13.3**	**29.4**	**28.6**	**4.9**	**9.6**

The NYCs also enjoyed growth in non-retail business lines for a 24% increase in total revenues. Costs, led by a $1 billion spike in interest expense, also climbed but by a much smaller 17% for a quadrupling of profits to $418 million. That is still $200 million short of the NYCs' 1986 record profits. With most other firms struggling last year, this allowed the NYCs to capture a record 17% of NYSE firm profits, a much higher proportion than their 11% share of revenues.

The retail-oriented NFLs lost money in their broker-dealer units for the second straight year or for the third time in the past five years. Their total revenues fell 7% in 1988 while expenses were trimmed slightly more, 7.5%, producing a slightly smaller loss than in 1987.

Regional firms, also heavily dependent on retail business, saw their profitability plunge 50% in 1987 and then plummet an even further 61% last year.

At $107 million, the Regionals' 1988 pre-tax profits were the second lowest of the Eighties (only 1984's $84 million was lower). Furthermore, Regionals' 1988 pre-tax profit margin of 5.4% was their lowest of the Eighties. As for total revenues' 15% fall to $4.2 billion, this led to the first substantial drop in Regionals' share of NYSE firms' revenues in five years, with Regionals' share now at 8% after four years at a 10% and even higher shares previously.

As for share of profits, initially the Regionals weathered the impact of the crash better than other firms in general. In 1987, they maintained their 10% share of revenues but captured 23% of (albeit small) profits. Last year, Regionals only cornered 4% of profits since most of these profits were not retail-sourced.

The most retail and commission-oriented group of firms, the Discounters, experienced a 19% drop in revenues last year but could only slash costs by a smaller 14%. This led to a dramatic 71% drop in pre-tax profits to a mere $31 million in 1988.

The Discounters' pre-tax profit margin of 3.1% last year and ROE of 5.0% were the lowest of the NYSE group's, excluding the NFLs' broker-dealer losses, and the Discounters' worst showing since 1984.

What needs to be seen this year are further cost savings from measures carried out in 1988 and early 1989. Compensation should be reduced further; occupancy and equipment costs should fall or at least level out; management controls should prevent further huge trading losses; hopefully, recovering markets should lead to higher equity-related revenues and bring to fruition some previous merchant banking deals.

Initial Q1 results from publicly held firms indicate that commissions will rebound but principal transactions and investment banking revenues will be down. Compensation and total expenses should show a nice downward movement but occupancy costs probably will not be dented yet. And as for profitability, the initial reports of publicly held firms suggest continued disappointment for the retail firms: NFLs and Regionals may show no improvements and possible further deteriorations. The softer capital market areas may sharply reduce profits for the LIBs. However, the year has only begun and a market recovery is as inevitable as taxes -- it's just a matter of timing.

EXHIBIT A-1

STATEMENT OF INCOME
NATIONAL FULL LINE FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	5,354.3	3,602.9	(32.7)
Trading Profits	4,414.0	5,118.2	16.0
Investment Gains	(82.3)	185.5	NM
Underwriting	2,475.9	2,524.7	2.0
Margin Interest	1,673.9	1,610.5	(3.8)
Mutual Fund Sales	1,579.7	1,087.6	(31.2)
Fees, Account Supervision	748.2	811.3	8.5
Commodities	792.2	781.4	(1.4)
Other Securities Related	4,232.0	3,641.6	(14.0)
Other Unrelated	495.2	800.8	61.7
Total Revenues.	21,683.2	20,167.1	(7.0)
Expenses			
RR Compensation	5,698.9	4,616.4	(19.0)
Clerical Compensation	4,606.5	4,747.5	3.1
Partner Officer Comp.	262.6	150.1	(42.8)
Floor (Commission Clearing)	560.6	428.2	(23.6)
Communications	1,493.4	1,526.7	2.2
Occupancy & Equipment	1,531.9	1,654.1	8.0
Promotional Costs	687.5	562.9	(18.1)
Interest Expense	4,576.4	3,764.4	(17.7)
Errors Bad Debts	630.1	325.3	(48.4)
EDP	252.9	243.0	(3.9)
Non-Recurring Charges	30.1	24.8	(17.6)
Regulatory Fees	170.7	221.2	29.6
Other	1,373.9	1,970.5	43.4
Total Expenses	21,875.8	20,235.3	(7.5)
Pre-Tax Net Income	(192.6)	(68.2)	NM

EXHIBIT A-2

STATEMENT OF INCOME
LARGE INVESTMENT BANKS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,816.1	1,159.8	(36.1)
Trading Profits	3,830.5	3,870.8	1.1
Investment Gains	95.3	287.7	201.9
Underwriting	1,814.0	1,864.4	2.8
Margin Interest	610.3	486.4	(20.3)
Mutual Fund Sales	39.7	18.2	(54.2)
Fees, Account Supervision	352.9	399.2	13.1
Research	1.0	(0.3)	(130.0)
Commodities	197.2	432.4	119.3
Other Securities Related	4,727.9	7,516.2	59.0
Other Unrelated	1,289.2	1,014.3	(21.3)
Total Revenues	14,774.2	17,049.1	15.4
Expenses			
RR Compensation	1,437.5	1,111.0	(22.7)
Clerical Compensation	2,172.0	2,357.0	8.5
Partner Officer Comp.	599.5	637.0	6.3
Floor (Commission Clearing)	478.8	464.6	(3.0)
Communications	444.5	410.4	(7.7)
Occupancy & Equipment	554.6	655.5	18.2
Promotional Costs	241.3	193.5	(19.8)
Interest Expense	6,735.8	8,655.3	28.5
Errors Bad Debts	168.8	19.0	(88.7)
EDP	253.7	267.5	5.4
Non-Recurring Charges	59.2	11.5	(80.6)
Regulatory Fees	41.4	38.4	(7.2)
Other	894.9	795.5	(11.1)
Total Expenses	14,081.6	15,616.1	10.9
Pre-Tax Net Income	692.6	1,433.0	106.9

EXHIBIT A-3

STATEMENT OF INCOME
REGIONAL FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,813.0	1,324.8	(26.9)
Trading Profits	819.8	879.5	7.3
Investment Gains	37.3	50.5	35.4
Underwriting	629.2	541.4	(14.0)
Margin Interest	314.0	294.1	(6.3)
Mutual Fund Sales	533.3	258.9	(51.5)
Fees, Account Supervision	107.8	113.0	4.8
Research	10.2	13.2	29.4
Commodities	48.9	49.0	0.2
Other Securities Related	531.7	546.2	2.7
Other Unrelated	117.1	131.0	11.9
Total Revenues	4,960.7	4,201.7	(15.3)
Expenses			
RR Compensation	1,405.7	1,056.9	(24.8)
Clerical Compensation	915.1	831.9	(9.1)
Partner Officer Comp.	313.6	245.6	(21.7)
Other Compensation	139.1	164.1	18.0
Floor /Commission Clearing	230.4	173.1	(24.9)
Communications	327.9	315.5	(3.8)
Occupancy & Equipment	267.4	284.1	6.2
Promotional Costs	137.6	121.2	(11.9)
Interest Expense	396.7	412.0	3.9
Error Bad Debts	83.4	29.5	(64.6)
EDP	82.5	75.5	(8.5)
Non-Recurring Charges	2.0	4.5	125.0
Regulatory Fees	43.4	41.8	(3.7)
Other	341.6	339.0	(0.8)
Total Expenses	4,688.1	4,094.5	(12.7)
Pre-Tax Net Income	272.6	107.2	(60.7)

EXHIBIT A-4

STATEMENT OF INCOME
NEW YORK CITY-BASED FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,561.5	1,076.8	(31.0)
Trading Profits	621.0	1,059.0	70.5
Investment Gains	(77.3)	354.1	NM
Underwriting	116.9	80.4	(31.2)
Margin Interest	207.8	174.7	(15.9)
Mutual Fund Sales	37.6	26.7	(29.0)
Fees, Account Supervision	339.4	338.5	(0.3)
Research	5.1	2.2	(56.9)
Commodities	11.8	36.8	211.9
Other Securities Related	1,340.4	2,214.4	65.2
Other Unrelated	372.1	267.7	(28.1)
Total Revenues	4,536.6	5,631.1	24.1
Expenses			
RR Compensation	527.3	554.1	5.1
Clerical Compensation	743.7	695.4	(6.5)
Partner Officer Comp.	150.7	138.1	(8.4)
Other Compensation	210.8	83.3	(60.5)
Floor (Commission Clearing)	325.9	237.4	(27.2)
Communications	145.0	156.1	7.7
Occupancy & Equipment	178.0	234.8	31.9
Promotional Costs	75.9	77.3	1.8
Interest Expense	1,503.6	2,468.8	64.2
Error Bad Debts	28.9	18.7	(35.3)
EDP	58.1	58.6	0.9
Non-Recurring Charges	7.8	9.9	26.9
Regulatory Fees	31.1	31.7	1.9
Other	451.8	448.1	(0.8)
Total Expenses	4,438.6	5,212.9	17.4
Pre-Tax Net Income	98.0	418.2	326.7

EXHIBIT A-5

STATEMENT OF INCOME
NYSE DISCOUNTERS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	717.5	481.6	(32.9)
Trading Profits	5.5	6.5	18.2
Investment Gains	(0.7)	7.1	NM
Margin Interest	192.4	179.9	(6.5)
Mutual Fund Sales	11.4	13.3	16.7
All Other	304.3	305.6	0.4
Total Revenues	1,230.4	994.0	(19.2)
Expenses			
RR Compensation	28.1	34.4	22.4
Clerical Compensation	140.4	133.7	(4.8)
Partner Officer Comp.	21.8	14.4	(33.9)
Other Compensation	117.6	92.6	(21.3)
Floor (Commission Clearing)	171.0	106.4	(37.8)
Communications	52.9	50.8	(4.0)
Occupancy & Equipment	58.5	73.6	25.8
Promotional Costs	29.9	21.1	(29.4)
Interest Expense	167.1	212.0	26.9
Error Bad Debts Non-Recurring	66.9	10.0	(85.1)
EDP	55.6	28.2	(49.3)
Regulatory Fees	4.3	5.5	27.9
Other	210.7	180.5	(14.3)
Total Expenses	1,124.9	963.2	(14.4)
Pre-Tax Net Income	105.5	30.8	(70.8)

VOLUME

	MAR 1989	YTD 1989	MAR 1988	YTD 1988	% CHG. YTD 1989 1988
AVERAGE DAILY SHARE VOLUME (IN					
NYSE (MILS.)*	155.1	160.6	176.1	178.6	-7.7%
AMEX (MILS.)*	11.2	11.9	12.4	10.8	10.5%
NASDAQ (MILS.)*	131.1	131.2	137.2	128.6	2.0%
REGIONAL EXCHANGE (MILS.)*	N/A	N/A	24.9	25.0	N/A
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$123,270	$359,498	$134,828	$371,533	-3.2%
AMEX (MILS.)	2,951	7,612	3,681	8,432	-9.7%
ODD LOT SHARES PURCHASED ON NYSE (THOUS.)	8,386	25,833	8,093	22,552	14.5%
ODD LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,901	50,337	18,027	44,783	12.4%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	53.4%	52.8%	52.8%	53.6%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,717	32,198	9,850	27,130	18.7%
AMEX OPTIONS	3,440	10,005	3,841	9,505	5.2%
COMMODITY	23,691	67,108	20,636	58,578	14.6%

*MONTHLY AVERAGE
N/A DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	MAR 1989	MAR 1988	% CHG MAR 1989-1988
DOW JONES INDUSTRIALS	2293.62	1988.06	15.37%
STANDARD & POOR S 500	294.87	258.89	13.90%
NYSE COMPOSITE	165.63	146.60	12.98%
AMEX MARKET VALUE INDEX	328.31	296.43	10.75%
VALUE LINE COMPOSITE	245.77	228.14	7.73%
NASDAQ COMPOSITE	406.73	374.64	8.57%

YIELDS

(MONTHLY AVERAGES)

	JAN 1989	JAN 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.35%	7.69%	(34)
CORPORATE BOND YIELDS (MOODY S)			
Aaa CORPORATE	9.62	9.88	(26)
Baa CORPORATE	10.65	11.07	(42)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

	1st Quarter 1989	1st Quarter 1988	% Change 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$70,892.9	$67,757.2	4.6%
Common Stock	$7,911.2	$7,731.2	49.4%
# of Common Stock Issues	59	58	1.8%
Preferred Stock	$559.3	$2,260.5	-75.3%
# of Preferred Stock Issues	17	48	-64.6%
Corporate Debt	$62,221.5	$57,761.5	14.6%
# of Corporate Debt Issues	869	745	8.3%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$14,104.4	$14,679.5	-11.6%
# of Issues	1,068	807	29.2%
Competitive	$3,435.7	$3,460.7	-1.0%
# of Issues	670	726	-7.6%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
SIA Tax Testimony	On April 13, SIA testified before the House Ways & Means Committee on the President's proposal to lower the capital gains tax rate to 15%. Using the 1978 and 1981 experience with lower capital gains rates and the relatively harsh treatment of investment income in the U.S. compared to other major countries, SIA urged Congress to improve the President's proposal and to enact a lower capital gains tax. On April 19, SIA testified before the same committee on the need to restore targeted tax savings incentives. The low U.S. savings and investment rate was compared to that of our international competitors and it was noted that almost all foreign nations use special allowances and exemptions to foster savings. SIA recommended that the tax treatment of investment income and the IRA experience be reviewed and reconsidered.	SIA Research Department
"1st Quarter Domestic Corporate Finance Rankings"	In an atmosphere marked by rising short-term interest rates and lingering event risk, many companies turned to the swap market for funds while waiting for a downturn in rates later in the year. Driven largely by swap related debt, domestic offerings rose to $70.7 billion in the first quarter, a slight improvement over $67.8 billion of stocks and bonds issued during the first three months of 1988. Merrill Lynch took top underwriting honors both in domestic and worldwide issuance. Extensive rankings by type of issues, including international.	Investment Dealers' Digest, April 10, 1989
1989 International Investor's Directory	Extensive information on the world of international investment including corporate addresses, telephone numbers, and officers. Ten major sections includes: international securities firms, investment managers, ADR listings, international stock and international databases.	Asset International, Inc. 18 Desbrosses Street New York, NY 10013

Item	Description	Source
"Trends in Banking Structure since Mid-1970s"	Article describes the major structural changes that have occurred in banking over the past decade at the national, regional, state and local level. During the period, the number of banking organizations has increased sharply. Banks have expanded beyond their traditional geographic borders, differences between commercial banks and nonbank financial institutions have diminished; and the number of bank mergers and acquisitions has soared. Concludes: the factors responsible for these developments are still at work and will likely lead to continued rapid change in banking structure.	Federal Reserve Bulletin March 1989
"A National Lottery Is Not Such A Long Shot"	This year, 28 states and the District of Columbia are running lotteries, which have been the fastest growing source of state revenues in the 1980s. With a deadlock over how to cut the federal budget deficit and no one wanting to be first to mention tax, lotteries alone pass the White House "duck" test. Interesting musings on a federal lottery.	Business Week April 10, 1989
"Rewards of Risk"	On average, mutual funds ended the first quarter up 4.30%, lagging the major market indexes. Stock funds far outpaced bond funds, rising 6.15% for the quarter, versus fixed-income funds' paltry 1.17% return. However, the first quarter's results look positively electrifying compared to the last quarter of 1988. Quick review of of mutual funds first-quarter performance.	Barron's April 10, 1989
"Wary of Junk Bonds"	In spite of the growing respectability of junk bonds, the current size and liquidity of their market and the returns they have generated, pension funds are still cool toward high-yield bonds for fiduciary assets. Results of II poll of pension funds involvement in junk bond markets.	Institutional Investor April, 1989